HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

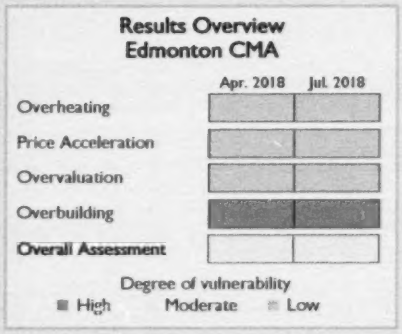
Edmonton CMA

Date Released: Third Quarter 2018

Canada

CMHC SCHL

Highlights



- The HMA framework continued to detect a moderate degree of vulnerability in the Edmonton housing market, unchanged from the previous quarter.[1]
- Evidence of overheating, price acceleration and overvaluation remained low, however, some indicators of overvaluation have been trending towards the threshold in recent quarters warranting some cautionary mention.
- The inventory of completed and unsold units and the rental vacancy rate both remained above their respective thresholds indicating overbuilding in the Edmonton housing market.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the HMA, CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's Market Analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects degrees of vulnerability in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolving an excess supply imbalance by supporting stronger demand and/or reducing supply. However, other unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance.

Colour codes indicate the degrees of market vulnerability. The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is from its historical average), and the persistence over time. Generally, low intensity and persistence are associated with potentially low degree of vulnerability. As the number of intense and persistent signals increases, the associated degree of vulnerability increases.

In Detail

Overheating

The Housing Market Assessment (HMA) framework detected low evidence of overheating in the Edmonton housing market.

The sales-to-new-listings ratio (SNLR) remained significantly below its threshold and declining, indicating that the supply of new listings coming onto the market has been outpacing demand. The seasonally adjusted SNLR averaged 48% in the first quarter of 2018, down from 53% in the fourth quarter of 2017 and well below the threshold of 85% which would indicate overheating.[3] After a temporary recovery in sales in the fourth quarter of 2017, the pace of sales moderated in the first quarter of 2018. Meanwhile, seasonally adjusted new listings have been on the rise since the second quarter of 2017 contributing to overall buyers' market conditions.

Price Acceleration

CMHC's indicator for price acceleration continued to detect low evidence for the Edmonton housing market in the first quarter of 2018. The MLS® Average Price

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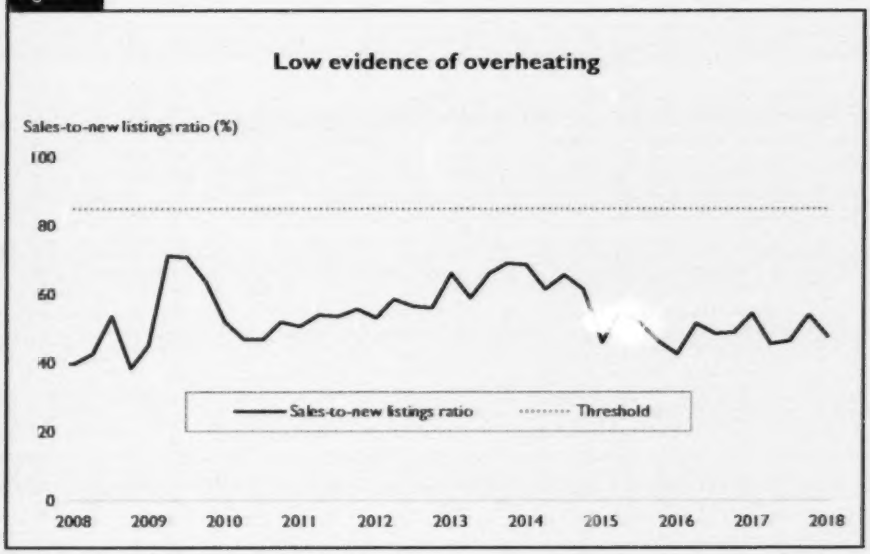
[1] Results are based on data as of the end of March 2018 and local market intelligence up to the end of June 2018. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

[3] Canadian Real Estate Association (CREA)

Figure 1



Source: CREA, calculations (threshold) by CMHC
Last data point: 2018Q1

in the Edmonton CMA has seen minor fluctuations, both positive and negative, since the second quarter of 2017 largely due to changes in both sales composition but also differences in market conditions between housing types. MLS® Average Prices appear to have stabilized and have even seen minor price increases in recent months in the single-detached segment. Meanwhile, prices in the condominium segment have been declining at a faster pace since mid-2017.[4] While economic fundamentals have improved recently, conditions in the existing home market continue to favour buyers' as demographic fundamentals have softened and inventories of both new and existing homes on the market have increased in recent quarters.

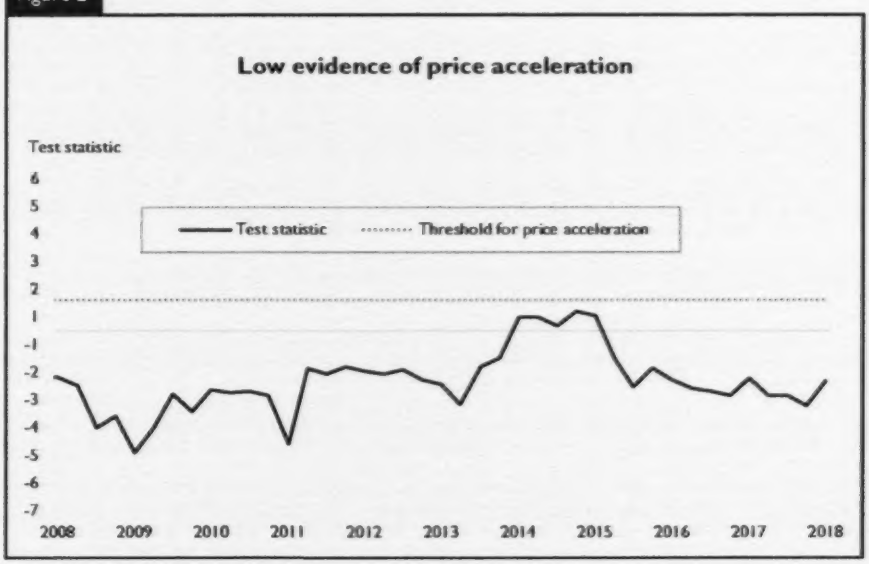
Taylor Pardy
Senior Analyst,
Economics (Edmonton)

"For the fourth consecutive quarter, evidence of overbuilding remained high as imbalances in both the ownership and rental market continued to be detected. Evidence of overheating, price acceleration and overvaluation remained low, however, some caution is warranted for the overvaluation metric going forward."

Overvaluation

The Edmonton housing market continued to show low evidence of overvaluation in the first quarter of 2018. Home price estimates, based on a number of measures, were consistent with economic, demographic and financial market fundamentals. Labour market fundamentals in the Edmonton CMA have been improving since September 2017 with strong positive full-time job growth and growth in wages. However, demographic fundamentals have deteriorated in recent quarters as the growth rate of the young adult population compared to the first quarter of 2017 declined significantly. As a result of these changes in demographic fundamentals

Figure 2



Source: CREA, CMHC calculations
Last data point: 2018Q1

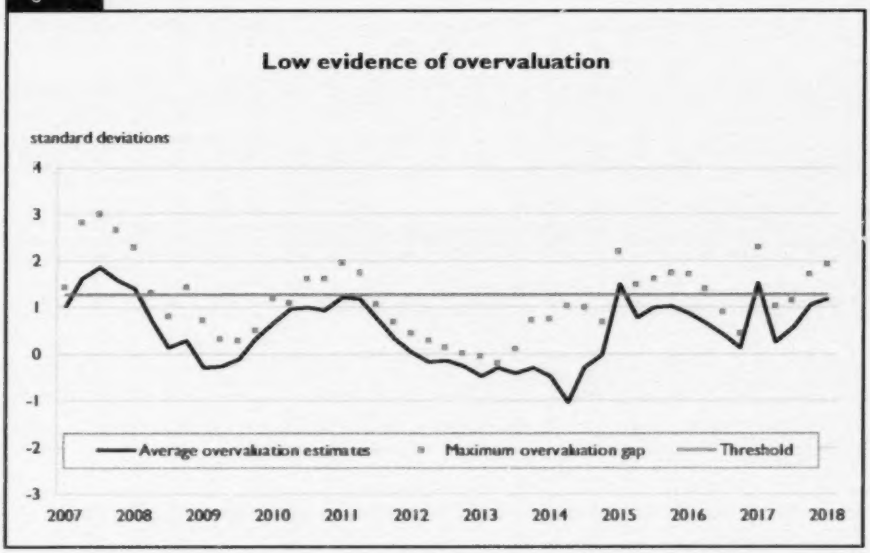
[4] Edmonton Real Estate Board (EREB)

some indicators considered in the overvaluation modelling framework trended closer to the critical threshold indicating overvaluation. If weaker demographic fundamentals and elevated supply levels persist, it is possible that the overvaluation rating for the Edmonton CMA could change in subsequent quarters.

Overbuilding

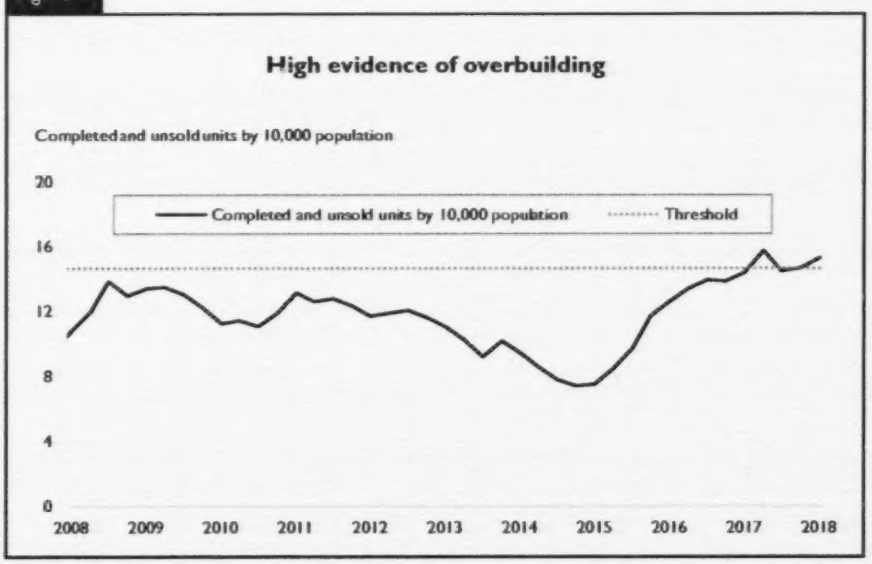
Strong evidence of overbuilding in the Edmonton housing market persisted in the first quarter of 2018 as imbalances in the ownership and rental markets were detected. The population adjusted inventory of completed and unsold new homes moved above the threshold for overbuilding in the fourth quarter of 2017 and has remained above the threshold since. While inventories have been trending upward since 2015, the pace of construction has slowed and the number of units currently under construction has moderated significantly which may cause inventory levels to stabilize in the coming quarters. The vacancy rate in the primary rental market, at 7.0% as of October 2017, also remained above its threshold level. Despite the addition of another 2,399 rental units to the rental stock in 2017, the vacancy rate in the Edmonton CMA remained largely unchanged, indicating demand kept pace with new supply coming onto the market. A shift in the rating for overbuilding going forward is likely to hinge on how well strengthening economic fundamentals translates into a recovery in demographic fundamentals and housing demand through the remainder of the year. On a provincial level, signs of a shift in demographic fundamentals are beginning to emerge as interprovincial migration turned more definitively positive in the first quarter of 2018.[5]

Figure 3



Sources: CREA, Statistics Canada, Teranet and National Bank of Canada, and calculations by CMHC.
Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. These include demand, supply, hybrid, and affordability models, each of which is estimated using four measures of house prices to generate sixteen unique estimates of overvaluation. The selection of models is conducted with a set of cointegration tests, and the selected models are estimated with Dynamic Ordinary Least Squares (DOLS). The maximum overvaluation gap is obtained from the model that has the largest gap between the actual price and the estimated price. The threshold is fixed at a critical value of 1.29 for a confidence level of 80%. Overvaluation is signaled when overvaluation estimates lie above the threshold. Last data point: 2018Q1

Figure 4



Source: Statistics Canada and CMHC
Last data point: 2018Q1

[5] Statistics Canada – Estimates of the components of interprovincial migration, quarterly – Table 17-10-0020-01

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (1) overheating (when demand outpaces supply); (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding (when the inventory of available housing units is elevated).

For each factor, the framework tests for: (1) the incidence of signs of vulnerability, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify signs of overheating, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers. The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed. To assess signs of overbuilding in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators that can identify imbalances. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators showing vulnerability from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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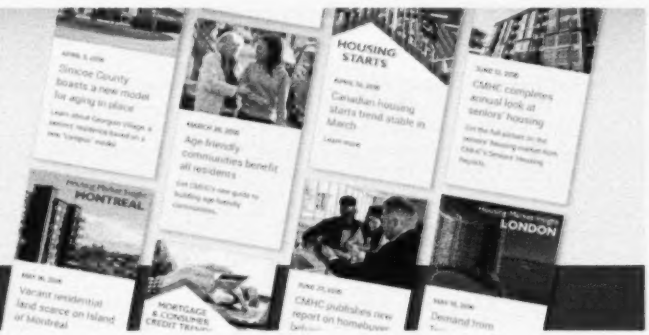

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